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DISTINGUISHING THE COMPONENTS OF HOUSEHOLD FINANCIAL WEALTH: THE IMPACT OF LIABILITIES ON ASSETS IN EURO AREA COUNTRIES

Abstract:

This paper studies the interdependence of households' financial assets and liabilities in European countries. Most studies treat household liabilities as negative assets and relate households' decisions to their net wealth. However, the components of net wealth, i.e. financial liabilities, financial assets and real assets are very heterogeneous across households. The assumption of similar consumption behaviour among households with the same net wealth but different wealth components is implausible. This paper raises another question, namely whether households consider their indebtedness when they make decisions about their financial assets.

The implication of household indebtedness for household behaviour is an important topic as household debt volumes have increased markedly in developed countries over the last three decades. There is a long list of research about household borrowing and the financial vulnerability of indebted households, but there has been less discussion about whether and how indebtedness affects households' behaviour beyond their borrowing decisions. The indebtedness has implications for households' consumption behaviour as well as for their choices regarding financial assets. There is a lack of empirical evidence on the effect of indebtedness on households' financial asset holdings in the middle of a recession.

This paper sheds more light on the relationship between liabilities and financial asset holdings. The paper uses data from the recently introduced Household Finance and Consumption Sur-vey. The paper uses the first wave of the HFCS, which was implemented in 2009-2010 in 13 euro area countries. A system of equations for financial liabilities and financial assets is esti-mated while allowing for endogeneity of the two wealth components. Furthermore, selection bias issues are addressed by estimating the control equation for the selection model of debt ownership. The results suggest that households' liabilities impact households' financial assets negatively while no significant effect was found from financial assets to liabilities. The nega-tive impact of liabilities on financial assets remains after controls for the debt service burden and for saving to pay back debt are included.

The results are confirmed by a large number of robustness tests. The findings provide empirical evidence for the theoretical assumption that credit markets reduce the holdings of financial assets of households. The results posit that increasing volumes of household debt are followed by lower incentives to keep financial assets. It is particularly important to understand how households' liabilities affect their other financial decisions as the penetration of debt and the volumes of debt have increased.

Keywords:

household debt, household wealth, financial assets, liabilities, financial vulnerability

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